No. 13700

IN THE

United States Court of Appeals
FOR THE NINTH CIRCUIT

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*

vs.

STANLEY HEDGES CHILDRESS, *Respondent*

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

Brief for Respondent, Stanley Hedges Childress

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BRIEF FOR RESPONDENT, STANLEY HEDGES CHILDRESS

OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 50-61) are reported at 18 T. C. 681.

JURISDICTION

On April 17, 1750, the petitioner, Commissioner of Internal Revenue (hereinafter referred to as "Commissioner"), mailed to respondents (hereinafter referred to as "Taxpayers"), notices of deficiencies in income taxes for the year 1944, for each taxpayer (R. 10-11). The taxpayers filed petitions for redetermination with the Tax Court on June 26, 1950, and July 10, 1950 (R. 3-9), under the provisions of section 272 of the Internal Revenue Code. The petitions were heard on October 9, 1951, in a consolidated proceeding, and the Tax Court entered its decision on August 19, 1952 (R. 64-65). The cases were brought to this court by the petitions for review filed by the Commissioner on November 12, 1952. The jurisdiction of this court rests upon Section 1141 of the Internal Revenue Code as amended by Section 36 of the Act of June 25, 1948.

STATEMENT

There is no real controversy in this case as far as the facts are concerned, and the Commissioner's statement of the case is accurate, except for his indication that four Judges of the Tax Court dissented in the Tax Court's decision. Actually, two judges concurred in the result and two judges dissented (R. 60 and 61).

SUMMARY OF ARGUMENT

John T. Hedges was a fiduciary whether as constructive trustee, executor or guardian, or by reason of the family relationship. When a fiduciary receives income he is required to pay taxes thereon in the year the income is received unless such income is distributable, in which event it is taxable to the beneficiary in the year in which the fiduciary receives the money. The taxpayers here paid the tax on the dividends declared by the Sunshine Mining Co., and received by the taxpayer in the year 1944. No claim is made by petitioner against the taxpayer for preceding years. The Government has already received more income tax from the dividends in question than it would have received had the stock and the dividends therefrom been turned over promptly and in accordance with law to the taxpayer at the time the taxpayer was entitled thereto. In fact, by reason of exemption and low income there would have been little or no tax due the commissioner had the dividends been turned over to the taxpayers in the year declared. It is neither justice or good law to impose upon the innocent victim of one who has taken property wrongfully, a large tax, at extremely high rates when that tax would not have been due particularly at such high rates had there been no conversion by the grandfather, of the Sunshine Mining Company stock.

RESPONDENT'S ARGUMENT IN SUPPORT OF DECISION OF THE TAX COURT OF THE UNITED STATES

While respondent, Stanley Hedges Childress, is filing a separate brief in these proceedings, in as much as the cases are consolidated and in order to avoid repetition, the respondent, Stanley Hedges Childress, concurs in and adopts the arguments presented in the brief of Ralph E. Hedges, also a respondent in these proceedings.

These cases consolidated pertain to proposed deficiencies in income taxes against each respondent separately for the calendar year of 1944. The essential facts in each case are substantially the same with the exception of one or two matters hereinafter explained. Each respondent is represented by separate counsel.

In the Childress case the amount of the deficiency set aside by the Tax Court of the United States is the sum of $33,762.08 together with interest thereon from March 15, 1945, until paid (R. pp. 10-13).

Stanley Hedges Childress, respondent, is the grandson of John T. Hedges. John T. Hedges and Kitty J. Hedges were married April 25, 1888. Of this marriage there were two children, Ralph Hedges, one of respondents, and Ruth Hedges, later Ruth Hedges Childress, mother of Stanley Hedges Childress, respondent (R. 14). Kitty J. Hedges, grandmother of respondent, died intestate March 23, 1923 (R. p. 18). Prior to her death Kitty and John Hedges acquired certain shares of Sunshine Mining Stock which John Hedges did not list in the Kitty J. Hedges estate when the same was probated, but had said stock wrongfully reissued to him and transferred to him personally and kept it and used dividends therefrom as his own, although he was the administrator of the Kitty J. Hedges estate and should have listed the stock in those probate proceedings (R. pp. 14, 18-22).

Prior to the entry of the decree of distribution in the Kitty J. Hedges estate said John T. Hedges, grandfather of this respondent, was appointed guardian of the estate of Stanley Hedges Childress, the respondent, then a minor;

for the purpose of receiving and holding his (Stanley's) share of the Kitty J. Hedges estate, she having died without a will, and Stanley's mother having predeceased her (R. 24, Ex. 8). Said John T. Hedges again failed to list said Sunshine Mining Stock in these guardianship proceedings as he was required by law to do and during the period of said guardianship proceeding failed to list said stock or any dividend thereof (Ex. 8). The final decree in the guardianship proceedings was entered without the guardian said John T. Hedges, ever disclosing said Sunshine Mining Company Stock and without ever disclosing the receipt of dividends therefrom (Ex. 8). The record shows that John T. Hedges included said dividends in his own personal income tax returns and paid taxes thereon at a higher rate that had said dividends been paid directly to respondent as they should have been (Ex. 7, R. 34, 35).

Upon the death of John T. Hedges February 1, 1944, Ralph Hedges, one of respondents herein and Stanley Hedges Childress, respondent, filed claims against the John T. Hedges estate each claiming a ¼ interest in the Sunshine Mining stock held by Kitty and John T. Hedges at the time of her death and each claiming an amount equal to the dividends received thereon by John T. Hedges since Kitty Hedges' death plus interest (Ex. 2B(0)). These claims were not litigated but were settled out of court. Respondent Stanley Hedges Childress was allowed in settlement of his claim 3550 shares of Sunshine Mining Stock and

$57,439.00 in cash and real property in 1944 (Ex. 2B). Petitioner contends said sum of $57,439.00 represented taxable income to the respondent in the year 1944. Respondent contends that said sum is not taxable in 1944.

In addition to the arguments made by Ralph Hedges, the respondent, Stanley Hedges Childress, in his brief filed herein, wishes to stress two additional arguments, the latter of which is applicable only to Stanley Hedges Childress.

CONSTRUCTIVE TRUST

As indicated by counsel for respondent Ralph Hedges, the testimony of Jessie Belton Dean, formerly Hedges, clearly demonstrates that Hedges recognized that he wrongfully had taken, held and used property belonging to both respondents (R. 31-32). Why else would he exact a promise from Jessie not to tell Ralph about the Sunshine stock? He knew from Ralph's action in Kitty's estate that Ralph would insist on an immediate surrender of the stock. He knew he had to deliver assets of Kitty's estate to Ralph and Stanley; in fact, as guardian, he acknowledged that he received for Stanley, Stanley's share of the assets of Kitty's estate, that is, that portion of her estate he chose to set forth in the inventory. His transfer of the Sunshine stock to his own name, clearly, was a conversion, in contemplation of law. See 53 Am. Jur., Sec. 12.

Whenever there is a conversion, there follows a constructive trust. The wrongdoer is the constructive trustee. His victim becomes the beneficiary.

Thus, Bogert, Trusts and Trustees, Vol 3 (Part 1) Sections 476, 481:

> "If one has possession of personal property under such circumstances that appropriation of it to his own use may not make him a criminal but he will be guilty of the tort of conversion in using the property for his own benefit, the wronged person may charge the convertor as a constructive trustee of anything of which he becomes the owner by reason of a sale of the thing converted.
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> * * *
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> "There are frequent instances of bailees being made constructive trustees of the proceeds of converted property."
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> * * *
>
> "A person who interferes with the estate of a deceased person or of a cestui que trust or an incompetent person may likewise be charged as a constructive trustee if he assumes the privilege of managing the estate and gets a property interest by virtue of such intermeddling."

In *Dominick v. Rhodes* (S. C. 1943), 24 SE (2d) 168, a father had appropriated his son's interest in the mother's estate—paralleling the case at bar. In impressing a constructive trust upon the assets in the father's hands the court said (p. 172):

> "It seems to us that this statement alone is sufficient to show that the law should apply and enforce a trust relationship as between the father and the son (there clearly being a confidential or fiduciary relationship between the parties by reason of the kinship and the surrounding circumstances), to the end that justice may be done."

So in the case at bar, John Hedges became constructive trustee and Ralph Hedges and Stanley Hedges Childress became beneficiaries, the corpus of the trust being their interest in the Sunshine Mining Company stock owned by the community composed of John T. and Kitty J. Hedges inherited by Stanley and Ralph under the laws of descent and distribution in the state of Washington (Rem. Rev. Stat., Sec. 1342).

As to Stanley Hedges Childress, the fiduciary character of the relationship is emphasized by the fact John T. Hedges was the duly appointed qualified and acting guardian of his estate, he being a minor, but failed to list the Sunshine stock or deliver same over on closing the guardianship (Ex. 8). As to respondent Stanley Hedges Childress the relationship is clearly not a fiction, but an express statutory trust.

It would appear that the case of *Hopkins v. Commissioner*, 41 B.T.A. 1292 is controlling here. There, in 1933, a court decree adjudicated taxpayer the owner of certain stock as of 1920 and awarded him the stock and the dividends earned thereon. In holding that taxpayer did not thereby acquire in 1933 taxable income, the tax court said (p. 1297 et seq.):

> "Consequently, in view of the provisions of the contract, and its construction by the Ohio court, it must be held that the petitioner was the owner of the shares from and after August 16, 1920. *Erie Railroad Co. v. Tompkins,* 309 U. S. 64. The decree does not purport to make the petitioner the owner of the shares from the time of the decree, but on the contrary, confirms his ownership from August 16, 1920.
>
> "Since petitioner was at all times the owner of the stock, we pass to the question of the dividends.
>
> "Under the statute, income is taxable to one on the cash basis in the year when received. Such is the general rule. (Sec. 42, Revenue Act of 1932; art. 331. Regulations 77. However, physical receipt by the taxpayer is not always necessary in order to sustain an application of the rule. There may be receipt by an agent, which is regarded as receipt by the principal, *Maryland Casualty Co. v. United States,* 251 U. S. 342; there may be constructive receipt, John A. Brender, 3 S.T.A. 231; Ella C. Leese, Executrix, 15 S.T.A. 169. As to dividends, 'there are different times at which it reasonably may be claimed the taxpayer receives them.' *Avery v. Commissioner,* 292 U. S. 210. Dividends on stock in trust received by the trustee and used by it to discharge debts of the owner are income to the owner. *Lucy v. Blumenthal,* 30 S.T.A. 591; affd. 296 U. S. 552.
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> * * *
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> "If it were to be said that the contract of August 16, 1920, made the Trust Co. a trustee for the petitioner, then the Trust Co. was under the duty of filing returns and reporting the distributions as they occurred, and its failure to do so can not now be charged to the petitioner.

"The decree of the court in 1923 did not create income. It merely declared ownership of the Buckeye stock in 1920 and required an accounting of the proceeds and avails of such stock. The income on the stock followed its ownership and receipt occurred in the preceding years. This is true of the cash as well as the other items comprised in the accounting. The decree did not cause conversion of assets into cash or make the cash income in 1933.

"Respondent's position, as above indicated, is primarily based on the ground of untaxed enrichment. If equitable consideration were to be taken into account, we could not fail to note that, though the action by Griffiths in reporting the dividends was entirely without legal sanction and wholly irregular, by reason of the fact that Griffiths' personal income was much greater than that of Hopkins, the Government probably was paid an amount of tax on account of the dividends much in excess of what it would have received had petitioner returned them properly and paid the tax in due course.

"The respondent seeks to fortify his position by citing various cases which hold that income received as the result of litigation is subject to taxation in the year in which the litigation is terminated. *However, in the case at bar we note that the action brought by the petitioner was for the purpose of compelling the return of property already owned, not for the adjudication of a claim.* As above indicated, the suit was a simple proceeding against Guardian for an accounting and to repossess property unlawfully withheld from the petitioner by that company. Thus, the cases relied on by the respondent are clearly distinguishable on facts.

"We conclude that no income was received by petitioner in 1933 as a result of the decree of the Ohio court, nor was there any capital gain."

The parallel to the case at bar is striking, indeed:

Here, as there, income tax was paid by the recipient of the dividends (John T. Hedges) each year as the dividends were received, at a higher rate than if the dividends had been paid directly to the taxpayer.

Here. as there, the decree allowing the claims of respondents did not create income, but merely declared and recognized respondents' ownership of the stock in 1923.

Here, as there the trustee "was under the duty of filing returns and reporting the distributions as they occurred, and it's failure to do so can not now be charged to the "respondents."

Also supporting respondent's contention, is the case of *Commissioner v. Owens.* 78 F2 768,, where the court stated (p. 776):

> "We must assume, in the absence of a contrary showing not here present, that the fiduciary returned and paid the tax thereon. *Whitcomb v. Kenderville,* 90 S. C. 384, 73 SE 775, 777.

> "The income tax laws do not contemplate that income shall be taxed twice, both against the fiduciary and also against the beneficiary. Therefore, when provision is made for taxation against the fiduciary and for payment of the tax by him, the government may not assert a tax against the beneficiary when the money is paid over to him. *Haag v. Commissioner,* 19 B.T.A. 982, 990.

> "We do not think it would alter the situation had the fiduciary failed to return and pay the tax, and had the

> government failed to enforce his liability so to do; but that question is not here presented."

See also Rabkin & Johnson, Income, Gift and Estate Taxation, Vol. 2, Sec. 54.06:

> "But where the beneficiary has a vested right to the income, such income is currently distributable. . . The intent of the statute is to insure that all of the trust's net income is taxed either to the trust or to he beneficiary *in the year the income is realized by the trust."*

In the case at bar, the income in question was included in the returns of John Hedges, and the tax was paid at an even higher rate than had it been actually distributed, as John Hedges was in a higher bracket than either of the respondents; here, clearly the purpose and intent of the statute as stated by the above authority has been amply fulfilled.

Generally, trust income is attributable to the trustee, when the income, under the trust agreement, is not distributable to the beneficiary. When, however, it is distributable, it is taxable in the year acquired by the trust whether actually distributed or not. Thus, in *St. Louis Union Trust Co. v. United States,* 3 F. S. 650, it is said (p. 654):

> "A trustee is a taxable person under the statute. *Merchants' Loan & Trust Co. v. Smietanka,* 255 U. S. 509, 41 S. Ct. 386, 65 L. Ed. 751, 15 A.L.R. 1305. Under the statutes applicable to this case the income of a trust is taxable to the trustee except where the entire net

income is, under the terms of the trust, to be distributed currently to the beneficiaries and except where the trustee has discretion to distribute the entire income, and actually distributes it, to the beneficiaries, in which case the beneficiaries, and not the trustee, are taxable.

"Section 219 (b) of the Revenue Act of 1926 (26 USCA Sec. 960 note) provides in substance that, where the income is to be distributed currently and regularly, the fiduciary shall be allowed a deduction in computing the net income of the trust, but the amount of such income shall be included in computing the net income of each beneficiary, whether distributed to them or not. Where therefore, the entire net income of the trust is actually distributed to the beneficiary under the terms of the trust or where it is held for the purpose of being currently and regularly distributed to the beneficiaries, the beneficiaries alone are liable for the tax, but where, as in this case, the income from a trust has not been distributed or paid by the trustee to the beneficiaries, and is not held by the trustee to be currently and regularly distributed to the beneficiaries, the trustee is liable under the statute for the tax upon the income of the trust.

"The provision of the statute that the beneficiaries shall be liable for the tax where the trustee has discretion to distribute the entire income to them, and actually does so, does not, we think, apply to this case. The trustee did not distribute the income or any portion of it to the beneficiaries, and neither did it hold the income received from the trust for the purpose of currently and regularly distributing it to the beneficiaries. Moreover, the trustee had no discretion to distribute the income, but was required to carry out the terms of the trust. In these circumstances, we think the trustee was properly taxed under the statute on the income received from the trust. *Jobes v. Crooks* (D.C.) 33 F. (2d) 1016; *Willcuts v. Ordway et al.* (C.C.A.) 19

F (2d) 917; *Blair v. Barton* (C.C.A.) 26 F. (2d) 765; and *Crocker et al. v. Nichols* (D.C.) 27 F. (2d) 596.

"In Henn, Trustee, 8 B.T.A. 190, the trust provided for distribution of so much of the income accrued to minor beneficiaries as was necessary or advisable in the judgment of the trustee for their maintenance, care, and education, and for the accumulation of the balance. The United States Board of Tax Appeals held that the income distributed was not taxable to the fiduciary, but that the balance held for accumulation and further distribution was taxable to the trustee."

These general rules are predicated upon the express language of the statute. (26 U.S.C.A. 161; 26 U.S.C.A. 162). The statutory langauge apparently applies to all trusts, as there is no limitation of the application of the statute by its language to express trusts. Therefore, the foregoing rules should be applied here; and if they are, there is no tax liability bar, regardless of whether the dividends received by John T. Hedges are deemed distributable or not to the beneficiaries of the constructive trust, for only the year 1944 is here involved. The tax for the dividends declared by Sunshine and received by Stanley in 1944 were paid (Ex. E, R. 49).

If the dividends are deemed undistributable in John T. Hedges' hands or distributable at his discretion, then the liability to pay the tax fell on him—which obligation he actually assumed. See *State Sav. Loan & Trust Co. v. Commissioner*, 63 Fed. (2d) 482, where the court stated (p. 483, 4):

"Petitioner was taxed as trustee under a trust indenture created by one Gardner and his wife for the benefit of their nine grandchildren. The issues arise out of and are determined by a construction of the trust agreement. It is petitioner's contention (1) that the trust instrument created not one, but nine separate trusts; one for each of their nine grandchildren respectively, and (2) that petitioner, as trustee, was unqualifiedly required to pay over the income to the beneficiaries. The board held that but one trust had been created and that the income was taxable to the trustee because he was endowed with discretion as to distribution of the trust income to the beneficiaries.

"The Revenue Act of 1926, Sec. 219 (a), 26 USCA 960 note, provides that the tax shall be assessed upon income of property held in trust when such income may, in the discretion of the fiduciary, either be distributed to the beneficiaries or accumulated.

"The trustee made no distribution of income during 1926-1928, the years in question. Only one income tax return was filed for the trust in both 1926 and 1927, but nine separate returns were filed in 1928.

"Material portions of the trust indenture are set forth in the margin verbatim.

* * * * *

"The trustee was given discretion as to the distribution of the income.

* * * * *

"The order of the Board of Tax Appeals is affirmed."

If distributable, then it is taxable to the beneficiaries *in the year received by the trustee,* whether distributed or not. See *Malcom v. Commissioner,* 97 F2 381, p. 383):

"The state court's order of 1931 approving the renewal of the lease contained no provision or instructions as to the distribution of the annual consideration payments and the action taken by the trustees in treating this income as future rents was by agreement of the parties only. But this agreement or understanding between the parties cannot affect the obligation to pay income tax as the Board of Appeals has decided. The tax may be imposed on petitioner as beneficiary even though the income has not in fact been paid to her if it was distributable to her. *Defrabant v. Com'r.* 2 Cir., 90 F. 2d 433; *McCrery v. Com'r.,* 5 Cir., 69 F. 2d 688. The test is whether the income of the trust was currently distributable and therefore taxable to the beneficiary; *it is not the receipt of income but the present right to receive it that controls. Blair v. Com'r.,* 300 U. S. 5, 57 S. Ct. 330, 81 L. Ed. 465; *Freuler v. Helvering,* 291 U. S. 35, 54 S. Ct. 308, 78 L. Ed. 634."

The application of the usual trust rules to a constructive trust situation seems to have been made in the Hopkins case, (41 B.T.A. 1292) set out at length above.

Again this was done in *Reizenstein, trustee, v. Commissioner,* 9 B.T.A. 1184. There one Louis Reizenstein, after starting probate of his father's estate, took possession of the assets and carried on the business of his father for many years. In refusing to tax him for the other heirs' lawful share of the income from the business, the court said:

"In view of the case, it is not necessary to decide whether the petitioner was a trustee for the benefit of the legatees, or was acting as agent for them. If he was their agent it is clear that the income received was taxable to the legatees and not to him as contended by the petitioner. *Maryland Casualty Co. v. United States,* 251 U. S. 253. * * *

"If it be conceded for the sake of argument that he was acting in the capacity of trustee, as contended by the respondent he was acting for those whose interests were definitely fixed by the terms of the will. The legatees had the right to their respective shares. There were no contingent interests. The income was neither to be accumulated nor held for future distribution under the terms of the will but each of the legatees was entitled to his share of the income.

"The assets and income therefrom belonged to the petitioner and the beneficiaries. The petitioner received the income for and in behalf of himself and the beneficiaries; and in the absence of any agreement that it should be accumulated or held for future distribution, the legatees were entitled to it as it came in. In 1922, the brothers and sisters of Louis Reizenstein claimed their interests in the estate and their rights were not questioned by anyone. Louis at that time purchased the interest of each for the sum of $11,000, which obviously represented compensation for their respective shares or interests in the corpus and also the accumulated profits to which each was entitled.

"Under section 219 of the Revenue Acts of 1918 and 1921, the beneficiaries are taxable on the distributive shares of the income, whether distributed or not. Gideon N. Stioff, et al., Executors, 2 B.T.A. 1109; Florence M. Smith, Executrix, 5 B.T.A. 225. *Cf. Esty v. United States,* 63 Ct. Cls. 455; *MvCaughn v. Cirard Trust Co.,* (C.C.A. 3rd Cir.) 19 Fed. (2d) 218."

By the very nature of a constructive trust, the beneficiaries thereof, as the "beneficiaries" did in the Hopkins case (41 B.T.A. 1292) and in the Reizenstein case (9 B.T.A. 1184), have a present right to receive the dividends in the year actually received by the trustee. From the very moment of the conversion, the right to receive dividends exists. It is a present and vested right. Therefore, under the foregoing rules, these dividends were taxable to respondent in the year actually received by the constructive trustee, John T. Hedges, and are not taxable to the respondent in 1944.

Clearly, such a result is just and equitable. Not only has Petitioner received from John T. Hedges more tax than it would have had he properly listed the Sunshine stock in question in the Kitty Hedges Estate, instead of converting it to his own use, but also, to hold otherwise, petitioner is subjecting these dividends to an onerous double taxation, both in the hands of the wrongdoer, and in the hands of the victim. It hardly seems right that petitioner should take advantage of the wrongdoer's act of conversion, to impose upon his innocent victim a double tax of this kind, at the highest rates in the history of this country.

We again repeat:

> "The intent of the statute is to insure that all of the trust's net income is taxed either to the trust or to the beneficiary in the year the income is realized by the trust." *Rabkin v. Johnson, supra.*

This has already been accomplished by the payments made by John T. Hedges, and does not require the imposition of the proposed deficiency.

THE GUARDIAN IS OBLIGATED TO PAY THE INCOME TAX

At the time of the death of Kitty Hedges, Stanley Hedges Childress, the respondent here, was a minor. Prior to the distribution of her estate, John Hedges was appointed the guardian of his estate. The entire guardianship file is a matter of record here (Tr. p. 22, Ex. 8). No where in these proceedings did John Hedges report or disclose the Sunshine stock in question. Obviously, as guardian it was his duty to do so, and judging by the testimony of Jessie Belton Dean, he recognized that duty.

Under the law of the State of Washington, it is the duty of the guardian to pay taxes. Rem. Rev. Stat., Sec. 1575 (5) requires the guardian "to pay all just debts due from such ward." This had been construed in the case of *Burgest v. Caroline,* 31 Wash. 62, to include taxes.

In 39 C.J.S. 159 it is stated that it is the guardian's duty to pay taxes, and further authority for this general proposition is found in *Shurtleff v. Rite,* 4 NE 407, 140 Mass. 213. Until the delivery or surrender of the stock in question to the ward, it was, therefore, the duty of John T. Hedges to pay the income tax upon the income from his ward's Sunshine stock.

Supporting that contention is Reg. Sec. 29.161—1:

"A guardian . . . is a fiduciary . . . and as such is required *to make and file the return for his ward and to pay the tax . . .*"

Again, I.R.C. Sec. 51 (R):

"The statute imposes upon a guardian . . . the duty of filing a return whenever the taxpayer is unable to make his own return."

To the same effect, Rabkin & Johnson, Vol. 1, Sec. 1.06 (2).

If, as the foregoing authorities amply indicate, it is the guardian's duty to return and pay the tax, clearly it was John Hedges' duty to do so until the stock was actually turned over to the ward, the respondent here. Clearly the respondent was unable to make his own return; he was very young, and furthermore, had no knowledge whatever of the Sunshine stock or his interest in it until 1944. The obligation to pay the tax was on the guardian, therefore, and not the ward.

Again, we submit, respondent should not be subjected to the deficiency in question.

REPLY TO ARGUMENT OF PETITIONER

Petitioner asserts that respondent cannot rely upon the doctrine of Constructive Trusts. This doctrine is hardly a fiction, particularly under the facts of this case. Certainly the doctrine and its effects are so thoroughly established by the books as to be classed as a reality rather than a fiction. There is no court in any of the 48 states that would refuse to apply the doctrine of constructive trust under the facts of this case. How can it be said then that it is a fiction?

Counsel relies upon the case of *Stoddard v. Eaton,* 22 F (2d) 184. In that case an express written trust agreement was entered into. Under its terms the trustor, the maker of the trust, was also the beneficiary. The trustor also retained the right to control the investment of the trust assets. He also reserved the right to revoke the trust at any time. And so although a written agreement was executed creating an express trust, in truth and in fact there was no true trust or actual trust created since all the incidents of ownership remained in the trustor. He retained the income, he retained the control over the assets and he retained the right to cancel the written document at any time. The District Court who rendered the decision in that case properly attributed the income from the so called trust assets to the trustor and properly gave the trustor the benefit of losses sustained by the trustee. *No constructive trust situation existed in that case.*

The language quoted by counsel on P. 10 of petitioner's brief was obviously unnecessary to the decision of that case. Certainly an examination of facts in that case will show that it is not authority for reversing the tax court here. As is said in 113 A.L.R. 458:

"And special statutory provisions have been enacted taxing the settlor in respect of the income of various types of trusts (see the annotations referred to above, in 101 A.L.R. 397; 109 A.L.R. 1048; and 106 A.L.R. 798), in effect disregarding the trust entity as to trusts falling within their terms and making it unnecessary, in determining the tax in respect of such income to decide whether there is in fact a trust.

"It may be noted that a few of the cases cited in the present annotation were decided under Federal revenue acts before the enactment of such special provisions and involved revocable trusts or trusts of other types, the income of which, if they had arisen under the later acts, would have been taxable to the settlor under such provisions without the necessity of deciding whether there was in fact a trust."

Likewise, the other cases cited, *Estate of Peck v. Commissioner,* 15 T. C. 788, 796; and *Prudence Miller Trust v. Commissioner,* 7 T. C. 1245 do not deal with a constructive trust situation but with a situation parallel to that in the Eaton case. Again they are obviously not authorities for reversing the tax court here. (Other cases indicating that a constructive trust might arise to offer relief are *Knight Newspapers v. Helvering,* 143 F (2d) 1007, at 1011, and *F. S. Buggia,* 32 B.T.A. 581).

We also call attention to the fact that counsel completely overlooks the fact that John T. Hedges certainly was taxable as a fiduciary with respect to Stanley Hedges Childress, since he was Stanley's guardian.

Counsel next refers to the two cases of *Commissioner v. Wilcox,* 327 U. S. 404, and *Rutkin v. United States,* 343

U. S. 139, distinguishing the two cases by the proposition that money wrongfully obtained wtih the true owner's knowledge even though involuntarily, is taxable gain. (Rutkin), whereas money wrongfully obtained without knowledge is not taxable (Wilcox). It apparently is counsel's position that John T. Hedges was in the position of Wilcox and therefore not taxable for the money wrongfully obtained and the tax therefore should fall upon respondent, which we think is a non sequitor. Counsel, here, however, fails to recognize that petitioner does not seek to tax the Sunshine Mining Company stock turned over to the respondent in 1944, but seeks only to tax in respondent's hands the sum of $57,439.00 in cash and property paid over to respondent in 1944, which amount was equivalent to the dividends on the Sunshine Mining Company stock received by John T. Hedges.

Counsel urges that the Wilcox case is controlling, but the supreme court there stated, (*Commissioner v. Wilcox,* 327 U. S. 404):

> "The very essence of taxable income, as that concept is used in Para. 22 (a) is the accrual of some gain, profit or benefit to the taxpayer. This requirement of gain, of course, must be read in its statutory context. Not every benefit received by a taxpayer from his labor or investment necessarily renders him taxable. Nor is mere dominion over money or property decisive in all cases. In fact, no single, conclusive criterion has yet been found to determine in all situations what is a sufficient gain to support the imposition of an income

tax. No more can be said in general than that all relevant facts and circumstances must be considered. See Magill, Taxable Income (1945).

"For present purposes, however, it is enough to note that a taxable gain is conditioned upon (1) the presence of a claim of right to the alleged gain and (2) the absence of a definite, unconditional obligation to repay or return that which would otherwise constitute a gain. Without some bona fide legal or equitable claim, even though it be contingent or contested in nature, the taxpayer cannot be said to have received any gain or profit within the reach of Para 22 (a). See *North American Oil Consolidated v. Burnet,* 286 U. S. 417, 424, 76 L ed 1197, 1200, 53 S Ct 613. Nor can taxable income accrue from the mere receipt of property or money which one is obliged to return or repay to the rightful owner, as in the case of a loan or credit. Taxable income may arise, to be sure, from the use or in connection with the use of such property. *Thus if the taxpayer uses the property himself so as to secure a gain or profit therefrom, he may be taxable to that extent.* And if the unconditional indebtedness is cancelled or retired taxable income may adhere, under certain circumstances, to the taxpayer. But apart from such factors the bare receipt of property or money wholly belonging to another lacks the essential characteristics of a gain or profit within the meaning of Para. 22 (a)."

* * * * *

"It is obvious that the taxpayer in this instance, in embezzling the $12,748.60, received the money without any semblance of a bona fide claim of right. And he was at all times under an unqualified duty and obligation to repay the money to his employer. Under Nevada law the crime of embezzlement was complete whenever an appropriation was made; the employer was entitled to replevy the money as soon as it was appropriated or to have it summarily restored by a

> magistrate. The employer, moreover, at all times held the taxpayer liable to return the full amount. The debtor-creditor relationship was definite and unconditional. All right, title and interest in the money rested with the employer. The taxpayer thus received no taxable income from the embezzlement."

It is therefore apparent that the Wilcox case is authority for the proposition that the dividends in question here properly were taxable to John.

Finally counsel relies upon the case of *United States v. Safety Car Heating Company,* 297 U. S. 88. That case involved an alleged infringement of a patent. After the infringement had been established by court proceedings, it was adjudicated that the taxpayer was liable for the profits earned during the period of infringement and that such profits were taxable in the year 1925, the year taxpayer's right to recover them first accrued. This case, of course, is readily distinguishable from the case at bar as the right to the Sunshine Mining Company stock and the right to receive the dividends thereof clearly accrued on the date of the death of Kitty J. Hedges in 1923, not when the claim was allowed in John T. Hedges estate. (See Hopkins 41 B.T.A. 1292). That right was also recognized by John T. Hedges as is evidenced by the testimony of Mrs. Dean. (R. p. 30).

In the *United States v. Safety Car Heating* Co. case, the taxpayer had no clear and unconditional right to the profits until the infringement of the patent was established by court action. This distinction has previously been recognized by the tax court (see *Hopkins v. Commissioner,* 41 B.T.A. 1292 quoted at length above), of which the tax court says: *"However in the case at bar we note that the action brought by the petitioner was for the purpose of compelling the return of property already owned, not for an adjudication of a claim."*

The same distinction, we submit. applies to the Safety Car Heating Co. case. Counsel also relies upon *Hort v. Commissioner,* 313 U. S. 28; *Mathey v. Commissioner,* 177 F. 2d 259 (C.A. 1st); *Durkee v. Commissioner,* 162 F. 2d 184 (C.A. 6th). These cases are similarly distinguishable and are not authority contrary to the holding of the tax court here.

We note that in the Rutkin case the court says:

> " * * * it would be an extraordinary result to hold here that petitioner is to be tax free because his fraud was so transparent that it did not mislead his victim and his victim paid him the money because of fear instead of fraud."

So here it would be an extraordinary result that would permit the Government to recover a double tax upon these dividends—and thus more than double the amount it should have received—by taking advantage of the wrongdoing of John and thereby visiting at extremely high progressive rates the tax upon the wrongdoer's victims, Stanley and Ralph.

Counsel argues that because a stock holder of the corporation pays tax upon dividends received even though the corporation also pays a tax upon its proceeds, that therefore, the tax payers in the instant case should not complain. We submit that the situation is wholly different. Here in truth there are three taxes—one paid by Sunshine, one by John T. Hedges and one by Stanley and Ralph, if petitioner is correct—upon the same earnings.

We respectfully submit that the decision of the tax court here is both good law and is eminently fair and just.

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